

UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF WASHINGTON

In Re:

LLS AMERICA, LLC,

Debtor,

BRUCE P. KRIEGMAN, solely in his  
capacity as court-appointed Chapter 11  
Trustee for LLS America, LLC,

Plaintiff,

v.

WILLIAM HANES, et al.,

Defendants.

NO: CV-11-357-RMP

Bankr. Case No. 09-06194-PCW11  
(Consolidated Case)

Adv. Proc. No. 11-80299-PCW11

ORDER ADOPTING THE  
BANKRUPTCY COURT'S REPORT  
AND RECOMMENDATION

This matter comes before the Court on the Report and Recommendation of the Honorable Patricia C. Williams, Bankruptcy Judge. The Report and Recommendation is filed as ECF No. 378 in bankruptcy adversary number 11-80299. The Court has reviewed the Report and Recommendation, the erratum, the

1 objections, the motion for summary judgment, the evidence filed in support and  
2 opposition to summary judgment, including the affidavits of Doris Nelson and  
3 Marie Rice, the opposition papers, and all other materials connected to the motion  
4 for summary judgment. The Court also has reviewed the Bankruptcy Court's order  
5 striking Ms. Rice's declaration and the order striking Ms. Nelson's declaration in  
6 part.

### 7 DISCUSSION

8 The Ninth Circuit recently issued its opinion in *Exec. Benefits Ins. Agency v.*  
9 *Arkison (In re Bellingham Insurance Agency, Inc.)*, 702 F.3d 553 (9th Cir. 2012).  
10 In that case, the Ninth Circuit approved of treating core proceedings for which  
11 bankruptcy courts lacked jurisdiction to enter final judgment as non-core  
12 proceedings. *Id.* at 566. Accordingly, bankruptcy courts may hear such claims and  
13 enter proposed findings of fact and conclusions of law for review in the district  
14 court. *Id.* Those portions of the findings to which there are objections are subject  
15 to de novo review in the district court. Fed. R. Bank. P. 9033(d).

16 In this case, the Bankruptcy Court entered its report and recommendation on  
17 a motion for summary judgment. Summary judgment is appropriate "if the movant  
18 shows that there is no genuine dispute as to any material fact and the movant is  
19 entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A key purpose of  
20 summary judgment "is to isolate and dispose of factually unsupported claims . . . ."

1 *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24 (1986). Summary judgment is “not  
2 a disfavored procedural shortcut,” but is instead the “principal tool[ ] by which  
3 factually insufficient claims or defenses [can] be isolated and prevented from going  
4 to trial with the attendant unwarranted consumption of public and private  
5 resources.” *Celotex*, 477 U.S. at 327.

6 The moving party bears the initial burden of demonstrating the absence of a  
7 genuine issue of material fact. *See Celotex*, 477 U.S. at 323. The moving party  
8 must demonstrate to the Court that there is an absence of evidence to support the  
9 non-moving party's case. *See Celotex Corp.*, 477 U.S. at 325. The burden then  
10 shifts to the non-moving party to “set out ‘specific facts showing a genuine issue  
11 for trial.’” *Celotex Corp.*, 477 U.S. at 324 (quoting Fed. R. Civ. P. 56(e)).

12 A genuine issue of material fact exists if sufficient evidence supports the  
13 claimed factual dispute, requiring “a jury or judge to resolve the parties' differing  
14 versions of the truth at trial.” *T.W. Elec. Serv., Inc. v. Pac. Elec. Contractors*  
15 *Ass'n*, 809 F.2d 626, 630 (9th Cir.1987). At summary judgment, the court draws  
16 all reasonable inferences in favor of the nonmoving party. *Dzung Chu v. Oracle*  
17 *Corp. (In re Oracle Corp. Secs. Litig.)*, 627 F.3d 376, 387 (9th Cir. 2010) (citing  
18 *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986)). The evidence  
19 presented by both the moving and non-moving parties must be admissible. Fed. R.  
20 Civ. P. 56(e). The court will not presume missing facts, and non-specific facts in

1 affidavits are not sufficient to support or undermine a claim. *Lujan v. Nat'l*  
2 *Wildlife Fed'n*, 497 U.S. 871, 888-89 (1990).

3 The Court received two timely objections. ECF Nos. 394, 395 in 11-80229.  
4 Defendants Gerald and Katherine Brown objected on the grounds that the  
5 Bankruptcy Court impermissibly disregarded the declarations of Doris Nelson and  
6 Marie Rice.<sup>1</sup> The second objection was brought by Attorney Dillon Jackson on  
7 behalf of a large subset of Defendants. Mr. Jackson challenges the Court's finding  
8 that Ms. Nelson's testimony fails to create an issue of material fact for the jury.

9 **Declaration of Marie Rice**

10 Evidence filed in support of a summary judgment motion must be  
11 admissible. *See* Fed. R. Civ. P. 56. Expert testimony is governed by Federal Rule  
12 of Evidence 702 which reads:

13  
14  
15 <sup>1</sup>The Browns also objected on the basis that this Court (and the Bankruptcy  
16 Court) lack personal jurisdiction over them. As the motion for summary judgment  
17 is only a motion for partial summary judgment, and the motion is targeted to issues  
18 common to all parties, the Court declines to address Defendants' argument because  
19 it does not impact the Court's determination of the questions raised in the summary  
20 judgment motion or the Bankruptcy Court's Report and Recommendation.

1 A witness who is qualified as an expert by knowledge, skill,  
2 experience, training, or education may testify in the form of an  
opinion or otherwise if:

3 (a) the expert's scientific, technical, or other specialized knowledge  
4 will help the trier of fact to understand the evidence or to determine a  
fact in issue;

5 (b) the testimony is based on sufficient facts or data;

6 (c) the testimony is the product of reliable principles and methods;  
7 and

8 (d) the expert has reliably applied the principles and methods to the  
facts of the case.

9 Fed. R. Evid. 702.

10 In *Daubert*, the Supreme Court held that “Federal Rule of Evidence 702  
11 imposes a special obligation upon a trial judge to ‘ensure that any and all scientific  
12 testimony ... is not only relevant, but reliable.’” *Kumho Tire Co., Ltd. v.*  
13 *Carmichael*, 526 U.S. 137, 147 (1999) (quoting *Daubert*, 509 U.S. at 589). In  
14 making this determination, the judge must make “a preliminary assessment of  
15 whether the reasoning or methodology underlying the testimony is scientifically  
16 valid and . . . whether that reasoning or methodology properly can be applied to the  
17 facts in issue.” *Daubert I*, 509 U.S. at 592-93.

18 The court is to conduct a “holistic” analysis of the expert’s testimony. *See*  
19 *United States v. W.R. Grace*, 504 F.3d 745, 762 (9th Cir. 2007). The court should  
20 review the expert’s opinion testimony for “overall sufficiency of the underlying

1 facts and data, and the reliability of the methods, as well as the fit of the methods  
2 to the facts of the case.” *W.R. Grace*, 504 F.3d at 765. When there is too great an  
3 analytical gap between the data and the opinion proffered, the trial court may  
4 properly exclude the testimony as unreliable. *General Elec. Co. v. Joiner*, 522  
5 U.S. 136, 146 (1997). The proponent of expert testimony has the burden of  
6 establishing that the admissibility requirements are met by a preponderance of the  
7 evidence. Fed. R. Evid. 104, 702 advisory committee’s note.

8 In her declaration, Ms. Rice concludes that Plaintiff’s financial experts did  
9 not have sufficient, reliable information to conclude that the Debtor was operating  
10 a Ponzi scheme. In its order striking Ms. Rice’s deposition, the Bankruptcy Court  
11 relied on the fact that Ms. Rice never reviewed the information possessed by the  
12 experts. The record bears this out. Ms. Rice reviewed the declarations of  
13 Plaintiff’s three experts: Charles B. Hall, Michael Quackenbush, and Dan Harper.  
14 Ms. Rice also reviewed Ms. Nelson’s affidavit, Plaintiff’s statement of undisputed  
15 facts, two articles, 10-K forms for four payday loan shops, and some estimated  
16 financial statements for the Debtor. However, there is no evidence that Ms. Rice  
17 actually reviewed the information upon which Msrs. Hall, Quackenbush, and  
18 Harper relied.

19 In contrast, Mr. Hall reviewed the actual business records of the business  
20 entities that comprise the Debtor. Mr. Quackenbush reviewed voluminous records

1 of bank accounts and investment transactions. Mr. Harper reviewed, among other  
2 things, the Debtor's financial ledgers, emails, Ms. Nelson's personal records, and  
3 reconstructed records produced by other experts.

4 Rule 702 requires expert opinions to be based on sufficient facts or data.  
5 Ms. Rice's opinion that Mr. Hall, Mr. Harper, and Mr. Quackenbush's opinions  
6 were inaccurate because they relied on incomplete data is not supportable because  
7 Ms. Rice had insufficient data to support such a conclusion. Ms. Rice simply does  
8 not know the contents of the records reviewed by Plaintiff's experts because she  
9 never read them. This Court agrees with the Bankruptcy Court, and overrules the  
10 Browns' objection to the Bankruptcy Court's decision to exclude Ms. Rice's  
11 testimony. Accordingly, the Bankruptcy Court was correct in its decision to  
12 disregard Ms. Rice's testimony when ruling on the motion for summary judgment.

### 13 **Affidavit of Doris Nelson**

14 The parties make two arguments in support of their challenge to the  
15 Bankruptcy Court's handling of Ms. Nelson's affidavit. The Browns argue that the  
16 Bankruptcy Court erred because its basis for discounting Ms. Nelson's opinion is  
17 not supported by law. Specifically, the Browns assert that an affidavit should not  
18 be disregarded for being "unsupported and self-serving" because that "goes to the  
19 weight and credibility of" the affiant, not to the admissibility of the affidavit. The  
20 Browns do not cite any authority for this proposition. The Ninth Circuit, however,

1 regularly has held that affidavits that are unsupported by specific facts cannot  
2 create a genuine issue of material fact. *F.T.C. v. Publishing Clearing House, Inc.*,  
3 104 F.3d 1168, 1171 (9th Cir. 1997) (citing *Hansen v. United States*, 7 F.3d 137,  
4 138 (9th Cir. 1993)). Accordingly, the Browns' objection is simply unsupported  
5 by the law.

6 Mr. Jackson's objection to the rejection of some of Ms. Nelson's affidavit is  
7 that Ms. Nelson's affidavit creates an issue of fact because it rebuts the  
8 presumption of intentional fraud created by the existence of a Ponzi scheme. Mr.  
9 Jackson argues that "[a]lthough a presumption of intent to defraud arises where a  
10 Ponzi scheme exists, proof of a lack of fraudulent intent rebuts the Ponzi  
11 presumption." Mr. Jackson cites no authority in support of this statement.

12 The Ninth Circuit consistently has held that the existence of a Ponzi scheme  
13 establishes intentional fraud. *Donell v. Kowell*, 533 F.3d 762, 770(9th Cir. 2008);  
14 *In re AFI Holding*, 525 F.3d 700, 704 (9th Cir. 2008) ("[T]he mere existence of a  
15 Ponzi scheme' is sufficient to establish actual intent under [11 U.S.C. § 548(a)(1)]  
16 or a state's equivalent to that section.") (quoting *In re Agric. Research and Tech.*  
17 *Grp., Inc.*, 916 F.2d 528, 534 (1990)). Plaintiff's expert materials establish that  
18 there is no genuine issue of material fact as to the existence of the Ponzi scheme.  
19 Accordingly, pursuant to Ninth Circuit precedent, actual fraud exists under both  
20 state and federal law.

1 The state-law relied upon by Defendants is unpersuasive. The *Sedwick v.*  
2 *Gwinn*, 73 Wn. App. 879 (1994), case does not involve a Ponzi scheme. Instead,  
3 the case involves a series of loans and collateral agreements. *Id.* at 883-84. It is  
4 the nature of a Ponzi scheme that gives rise to the finding of intentional fraud.  
5 Accordingly, *Sedwick* is inapposite.

6 The Court has reviewed the Report and Recommendation and the record in  
7 this case. Being in complete agreement with the Report and Recommendation, as  
8 modified by the erratum, **IT IS HEREBY ORDERED** that the Report and  
9 Recommendation, as modified by the erratum, is **ADOPTED IN ITS**  
10 **ENTIRETY.**

11 **IT IS SO ORDERED.**

12 The District Court Clerk is hereby directed to enter this Order and to provide  
13 copies to counsel and to any pro se defendants.

14 **DATED** this 19th day of August 2013.

15  
16 s/ Rosanna Malouf Peterson  
17 ROSANNA MALOUF PETERSON  
18 Chief United States District Court Judge  
19  
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